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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In re Petition of	)	
	)	
THE COALITION TO IMPROVE TAX CERTIFICATE POLICIES	)	
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Expansion of the Commission's Tax Certificate Policy Under Section 1071 of the Internal Revenue Code	)	

To: The Commission

PETITION OF THE COALITION TO IMPROVE TAX CERTIFICATE POLICIES

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PETITION OF THE COALITION TO IMPROVE TAX CERTIFICATE POLICIES

The Coalition to Improve Tax Certificate Policies (the "Coalition"), by its attorneys, hereby petitions the Commission to (i) refine and expand its policies for the issuance of tax certificates under Section 1071 of the Internal Revenue Code, 26 U.S.C. § 1071 (1988), and (ii) establish a joint working group between the FCC and the Internal Revenue Service ("IRS"") to coordinate and improve the tax certificate policies of the two agencies.[1/]

1/ The Coalition consists of broadcast licensees, minority enterprise small business companies, and brokers who have extensive experience with the Commission's tax certificate policies. The Coalition's members understand the tax certificate, how it works and how it can be improved. A list of the Coalition members is appended hereto as Appendix A.

I. INTRODUCTION AND SUMMARY

The Commission's tax certificate policy has emerged as a significant incentive for the implementation of FCC policy. Congress enacted Section 1071 in 1944 in connection with the Commission's multiple ownership rules. In 1978, the Commission expanded use of the tax certificate to promote minority ownership of broadcast stations.[2/] It revisited the minority tax certificate policy in 1982 and extended its use to advance minority ownership of cable television systems. Tax certificates have emerged as an effective means of advancing the Commission's minority ownership goals.[3/] The Commission should revisit the tax certificate policy in furtherance of its efforts to promote new investment in the broadcasting industry.[4/]

2/ See Statement of Policy on Minority Ownership of Broadcasting Facilities, 68 F.C.C. 2d 979, 42 Rad. Reg. 2d (P & F) 1689 (1978) (hereinafter "1978 Policy Statement"); Commission Policy Regarding the Advancement of Minority Ownership in Broadcasting, 92 F.C.C. 2d 849, 52 Rad. Reg. 2d (P & F) 1301 (1982) (hereinafter "1982 Policy Statement").

3/ Andrew C. Barrett, Commissioner, Federal Communications Commission, Minority Employment and Ownership in the Communications Market: What's Ahead in the 90's, Keynote Address to the Bay Area Media Conference, 9th Annual Western Regional Media Conference, San Francisco, California, April 21, 1990; Remarks of Alfred C. Sikes, Chairman, Federal Communications Commission, before the 1989 National Black Media Coalition Annual Conference, Oct. 13, 1989; Frank Washington, The Making of the Minority Tax Certificate: One Person's Perspective, Annual Seminar of the National Association of Minorities in Cable (1989) (unpublished).

4/ See Notice of Proposed Rule Making and Notice of Inquiry in MM Docket No. 92-51, FCC 92-96 (released April 1, 1992) (proceeding to review Commission's regulations and policies affecting investment in the broadcast industry); Report and Order in MM Docket No. 91-140, FCC 92-7 (released April 10, 1992 (relaxation of multiple ownership rules in light of economic changes in broadcast industry).

In recent years, the Commission has expanded use of the tax certificate to promote a variety of its policy goals. In 1985, the Commission invoked its authority to issue tax certificates to expedite settlements among nonwireline cellular telephone applicants.[5] In October, 1991, the Commission announced that it would issue tax certificates to AM licensees receiving financial compensation for surrendering their licenses for cancellation.[6] In July, 1993, the Commission announced it would grant tax certificates to private fixed microwave licensees operating in the 2 GHz spectrum band as an incentive to negotiate voluntary relocation agreements to accommodate Personal Communications Services ("PCS") and other emerging technologies.[7]

In response to the Omnibus Budget Reconciliation Act of 1993,[8] the Commission extended its tax certificate policy developed under Section 1071 to emerging technologies such as PCS and Interactive Video and Data Services ("IVDS").[9] Congress' purpose in authorizing tax certificates under Section 309(j)(4)(D) focused on

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5/ See Telocator Network of America, 58 Rad. Reg. 2d (P & F) 1443 (1985), recon. dismissed, 1 FCC Rcd 509, 61 Rad. Reg. 2d (P & F) 699 (1986).

6/ Review of the Technical Assignment Criteria for the AM Broadcast Service, 6 F.C.C. Rcd 6273, 6323, 69 Rad. Reg. 2d (P & F) 1395, 1423 (1991).

7/ Redevelopment of Spectrum to Encourage Innovation in the Use of New Telecommunications Technologies, ET Docket No. 92-9, 8 FCC Rcd 6589 (1993) ("2 GHz Microwave Relocation").

8/ 47 U.S.C. §309(j) (1993).

9/ See Implementation of Section 309(j) of the Communications Act -- Competitive Bidding, PP Docket No. 93-253, Third Report and Order, FCC 94-98 (released May 10, 1994 (Narrowband PCS); Fourth Report and Order, FCC 94-99 (released May 10, 1994) (IVDS Order.); Fifth Report and Order, FCC 94-178 (released July 15, 1994) (Broadband PCS Order). ("PCS and IVDS Orders") ensuring opportunity for designated entities, such as women- and minority-owned businesses, to participate in auctions and the delivery of spectrum-based services.

These recent initiatives attest to Congress' and the Commission's confidence in the tax certificate as a means of advancing its regulatory goals. It is a highly effective, non-intrusive means of fostering the agency's policy objectives. As such, the Commission should continue to seek ways to refine and improve its tax certificate policies. Toward that end, the Coalition requests that the Commission take the following actions:

1. Establish a working group between the FCC and the IRS to improve their respective policies for the issuance and use of tax certificates. The agencies should draw on their collective experience in administering the tax certificate to finds ways in which the tax certificate can become a more meaningful vehicle to promote investment and to further the FCC's regulatory goals. As a starting point, the FCC should propose that the IRS:

   (a) eliminate the current prohibition on reinvestment of the proceeds of a tax certificate transaction in publicly-held broadcast companies which hold their licenses through subsidiaries (this would greatly expand the number of publicly-traded stocks that would qualify as replacement property for holders of tax certificates); and

   (b) permit reinvestment of the proceeds of tax certificate transactions in partnerships.[10]

2. Issue a Policy Statement which would:

   (a) allow the use of the minority tax certificate policy to promote the creation of joint ventures and venture capital funds to invest in common carrier technologies (the fund would be able to deliver its investors tax certificates provided

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10/ These proposals were first advanced in a transition report to Chairman Sikes by the Citizens' Commission on Civil Rights. See W. Kennard, J. Smith and B. Marchant, "Minority Business Development and Equal Opportunity in the Telecommunications Industry" in One Nation, Indivisible: The Civil Rights Challenge for the 1990s 324 (1989) (Report of the Citizens' Commission on Civil Rights).

> that over 50% of the fund's revenues are derived from minority-controlled mass media companies);
>
> (b) eliminate the requirement that an investor in a minority-controlled broadcast or cable television company must have invested within the first year of the company's operation to qualify for a tax certificate upon the sale of the investor's interest in the company (any investor that provides new capital to such a company should receive a tax certificate, even if the investment was made after the first year of operation); and
>
> (c) expand the applicability of the tax certificate to cable programming networks, such as Black Entertainment Television, Inc.

The foregoing initiatives fully comport with the intent of the tax certificate policy and would build on the proven success of the tax certificate as a means of implementing Commission policies. The FCC initiatives outlined above (Items 2(a), (b) and (c)) involve minor refinements to the tax certificate policy and could be accomplished expeditiously through issuance of a Policy Statement. This approach is consistent with past actions by the Commission to expand and refine its tax certificate policies through the issuance of Policy Statements and is endorsed by the Commission's Office of Small Business Affairs.[11/] The IRS proposals (Items 1(a) and (b)) could be developed in the context of a joint IRS-FCC working group and adopted by the IRS in Revenue Rulings.

To the extent Commission and IRS policies under Section 1071 are extended to tax certificates issued under Section 309(j), the recommendations apply with equal force to the Commission's tax certificate policies under Section 309(j).

11/ Report of the FCC Small Business Advisory Committee (Gen. Docket 90-314), September 15, 1994.

II. THE TAX CERTIFICATE POLICY: HISTORY AND CURRENT USE

The Commission's tax certificate policy derives from Section 1071 of the Internal Revenue Code (the "Code").[12] A tax certificate enables the holder to defer the payment of federal income tax otherwise due if (a) the proceeds of the transaction are reinvested in appropriate "qualified replacement property" and/or (b) to the extent of any gain attributable to the ownership interest sold, the seller elects to reduce the tax basis of appropriate depreciable property (whether or not used in connection with a

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12/ 26 U.S.C. § 1071 (1988). Section 1071(a) provides, in pertinent part:

> If the sale or exchange of property (including stock in a corporation) is certified by the Federal Communications Commission to be necessary or appropriate to effectuate a change in a policy of, or the adoption of a new policy by, the Commission with respect to the ownership and control of radio broadcasting stations, such sale or exchange shall, if the taxpayer so elects, be treated as an involuntary conversion of such property within the meaning of section 1033. For purposes of such section . . . , stock of a corporation operating a radio broadcasting station, whether or not representing control of such corporation, shall be treated as property similar or related in service or use to the property so converted. The part of the gain, if any, on such sale or exchange to which section 1033 is not applied shall nevertheless not be recognized, if the taxpayer so elects, to the extent that it is applied to reduce the basis for determining gain or loss on sale or exchange of property, of a character subject to the allowance for depreciation . . . , remaining in the hands of the taxpayer immediately after the sale or exchange, or acquired in the same taxable year. . . .

Id.

broadcasting or cable television business) owned immediately after the sale or acquired within the same taxable year of the sale.[13]

Congress enacted Section 1071 in 1944 in response to the FCC's adoption of the so-called "multiple ownership rules." [14] Congress enacted Section 1071 to lessen the hardship imposed on broadcasters who were forced to divest stations under the Commission's multiple ownership rules.[15]

In the late 1970's, the FCC sought to create new opportunities for minority ownership in broadcasting. Several organizations, including the National Association of Broadcasters ("NAB"), the National Telecommunications and Information Administration of the U.S. Department of Commerce, the National Black Media Coalition, and the Congressional Black Caucus, met in 1977 under the auspices of the FCC to address the underrepresentation of minorities in broadcasting. That year, the NAB filed a Petition for Rule Making urging the FCC to extend its tax certificate policy to promote minority

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13/ For a more comprehensive discussion of the options available to the holder of a tax certificate, see Krasnow, Kennard and Temkin, Maximizing the Benefits of Tax Certificates in Broadcast and Cable Ventures, 13 COMM\ENT L.J. 753 (1991).

14/ Act of February 25, 1944, Ch. 63, § 123(a), 58 Stat 21, 44.

15/ See S. Rep. No. 627, 78th Cong., 1st Sess. (1943). Section 1071 authorized the FCC to issue a tax certificate to the owner of multiple broadcast stations upon the sale of a combination which was prohibited under the newly adopted multiple ownership rules.

ownership. Since the adoption of the policy in 1978,[16] the FCC has issued over 303 minority tax certificates.[17]

Since 1982, the FCC has issued tax certificates to investors who provide "start-up capital" to minority companies formed to acquire broadcast or cable properties.[18] Investors who provide "start-up" capital to a minority-controlled company will qualify for a tax certificate upon the sale of their investment in the company, provided that after such sale, the company remains controlled by minorities.[19] The Commission designed this aspect of the policy to enable minority companies to attract equity investors by

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16/ 1978 Policy Statement, supra, note 2.

17/ Consumer Assistance Branch, Public Service Division, Minority Ownership Lists (November 14, 1994) (periodically updated listing of the number of broadcast stations and cable television systems acquired with the benefit of the FCC's minority ownership policies).

18/ 1982 Policy Statement, 92 F.C.C. 2d at 849, 52 Rad. Reg. 2d (P & F) at 1307-09.

19/ The Commission provided the following example of how the policy works:

> [A]ssume shareholder A, a Black person, owns 70 percent of Corporation X, while shareholders B and C each own 15 percent. If B and C purchase their shares before or within one year after acquisition of a license, they can later sell their interest and be eligible to receive a tax certificate. Whether B and C and/or the subsequent buyers are racial or ethnic minorities would be inconsequential -- what is relevant is that B and C provided necessary financing enabling a minority-owned or controlled entity to acquire and start a broadcasting station, thereby increasing minority ownership in the market. So long as the entity is minority controlled, it is immaterial whether minority members own 51% or 91%.

1982 Policy Statement, 92 F.C.C. 2d at 849, 52 Rad. Reg. 2d (P & F) at 1307-08.

offering them the prospect of a tax certificate upon the eventual sale of their interests in the company.

In 1985, the Commission authorized the issuance of tax certificates to promote settlements among nonwireline cellular telephone applicants.[20] Changes in the Code which foreclosed these applicants from tax-free exchanges of cellular partnership interests under Section 1031 of the Code prompted the Commission to invoke the tax certificate policy in these circumstances. The Commission hoped that the creation of an incentive for nonwireline settlements would expedite nonwireline service and provide competition to wireline operators.

In October, 1991, the Commission announced that it would issue tax certificates to AM licensees receiving financial compensation for surrendering their licenses for cancellation.[21] The Commission adopted this policy initiative as part of its omnibus proceeding to improve the quality of AM broadcast service. The proceeding sought to eliminate underperforming, technically inferior AM broadcast stations from the AM band. Licensees of such stations will qualify for a tax certificate when receiving compensation for surrendering their licenses to the Commission for cancellation.

20/ See Telocator Network of America, 58 Rad. Reg. 2d (P & F) 1443 (1985), recon. dismissed, 1 FCC Rcd 509, 61 Rad. Reg. 2d (P & F) 699 (1986).

21/ Review of the Technical Assignment Criteria for the AM Broadcast Service, 6 FCC Rcd 6273, 6323, 69 Rad. Reg. 2d (P & F) 1395, 1423 (1991).

The Commission has also announced it will issue tax certificates to encourage private fixed microwave users to relocate their systems in the 2 GHz band to higher spectrum bands to accommodate PCS and other emerging technologies.[22/]

Most recently, Congress authorized the Commission to expand its tax certificate policy to ensure that businesses owned by minorities and women are able to provide spectrum-based services where licenses for such services are awarded by competitive bidding. Specifically, the Commission announced it would issue tax certificates to non-controlling initial investors in minority and female-owned narrowband and broadband PCS and IVDS applicants, upon the sale of their non-controlling interests. The Commission will also issue tax certificates to narrowband and broadband PCS and IVDS licensees who assign or transfer control of their licenses to minority- and women-owned entities.[23/] Congress' authorization of tax certificates under Section 309(j), although somewhat different than the purpose underlying Section 1071, demonstrates the efficacy of the Commission's tax certificate policy.

III. THE NEED FOR A JOINT IRS-FCC WORKING GROUP

Section 1071 confers upon the FCC broad jurisdictional powers, normally reserved to the Treasury, to issue tax certificates. The FCC's grant of a tax certificate is based on the agency's determination that the proposed sale or exchange of property is "necessary

22/ 2 GHz Microwave Relocation, supra, note 7.

23/ PCS and IVDS Orders, supra, note 9.

or appropriate to effectuate a change in a policy of, or the adoption of a new policy by, the Commission with respect to the ownership and control of radio broadcasting stations . . . ." 26 U.S.C. §1071(a). The statutory provision is unique because its implementation involves both the FCC and the IRS.[24]

The FCC first issues the tax certificate, but its use involves application of the IRS's rules on involuntary conversions and depreciable property basis reductions.[25] The FCC does not concern itself with how the taxpayer will use the tax certificate; the IRS does not second-guess the FCC's determination that the sale or exchange is "necessary or appropriate" to promote FCC policies and thus qualifies for tax certificate treatment.

Nevertheless, formal coordination between the two agencies on tax certificate matters could significantly enhance the effectiveness of the tax certificate as an incentive to advance FCC policies. The Coalition's experience with the tax certificate indicates that in at least two areas, the IRS's definition of "qualified replacement property" is unduly restrictive, and as a result, hampers the effectiveness of the tax certificate as an incentive to advance FCC policies.

24/ See Blake and McKenna, Section 1071: Deferral of Tax on FCC Sanctioned Dispositions of Communication Properties, 36 Tax L. Rev. 101 (1980).

25/ See Krasnow, Kennard & Temkin, supra, note 11 at 762-65.

A. **Prohibition on Reinvestment in the <u>Stock of a Broadcast Holding Company</u>**

The holder of a tax certificate may elect to reinvest the proceeds of the tax certificate in "qualified replacement property" to realize the tax deferral benefits available under Section 1071. Under such an election, the reinvestment is treated as an involuntary conversion under Section 1033 of the Code, which is ordinarily reserved for property that is stolen, condemned or destroyed.[26/] The replacement property must be "similar or related in service or use" to the converted property. In applying this standard under Section 1071, the IRS permits the taxpayer to change significantly the nature of the investment. Generally, it allows the seller to reinvest in different types of <u>electronic</u> media of <u>mass</u> communication and the investment may be in the form of assets or stock. Thus, qualifying replacement property under Section 1071 may consist of hard assets (<u>i.e.</u>, broadcast or cable assets) or stock in a corporation which derives more than 50 percent of its income from broadcasting or cable operations.[27/]

If the taxpayer chooses to reinvest in the stock of a broadcast company, the taxpayer must invest in a corporation that operates its broadcast stations <u>directly</u>, rather

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<u>26</u>/ The cost basis of the qualified replacement property acquired with the proceeds of the FCC certified sale will be reduced by the amount of gain not recognized under Section 1033(b) of the Code. This basis adjustment mechanism effectively reduces the adjusted basis of the newly acquired property by the amount of the gain that was generated but deferred with respect to the old property. This ensures that the deferred gain will ultimately be recognized and taxed when the replacement property is sold. Generally, the holder of a tax certificate who elects to reinvest the proceeds from the tax certificate in qualifying replacement property has two years following the year of sale in which to do so. 26 U.S.C. § 1033(a)(2)(B) (1991).

<u>27</u>/ <u>See</u> LTR 8421003 (Jan. 13, 1984).

than through subsidiaries.[28] In a 1966 revenue ruling, the IRS ruled out reinvestment in the stock of a holding company wherein the broadcast licenses are held through subsidiaries. Rev. Rul. 66-33, 1966-1 C.B. 183. This ruling effectively precludes reinvestments in publicly-traded broadcast companies because most publicly-traded broadcasting companies hold their FCC licenses through subsidiaries; they sell stock only at the holding company level.[29] The Coalition is aware of only one publicly-traded broadcast company, CBS Inc., which does not hold its broadcast licenses through subsidiaries.

Rev. Rul. 66-33 is the result of a literal reading of the language of Section 1071, which provides that for the purposes of the reinvestment option (under Section 1033), "stock of a corporation operating a radio broadcasting station, whether or not representing control of such corporation, shall be treated as property similar or related in service or use to the property so converted." 26 U.S.C. § 1071 (emphasis added). The legislative history of Section 1071 does not support so restrictive a reading of this provision.[30] Congress enacted Section 1071 as a remedial statute designed to lessen the hardship upon broadcasters forced to divest their broadcast holdings under the multiple ownership rules. To accomplish this end, Congress sought to provide these broadcasters with the flexibility to select various reinvestment options. Indeed, it appears

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28/ Presumably, this direct investment rule would apply to tax certificates issued with respect to PCS and IVDS.

29/ This limitation would also restrict reinvestment in the stock of publicly-traded cable television companies whose franchises are held through subsidiaries.

30/ See S. Rep. No. 627, 78th Cong., 1st Sess. (1943).

from the language on which Rev. Rul. 66-33 is based that Congress simply intended to allow holders of a tax certificate the flexibility to reinvest in less than a controlling interest in a broadcasting corporation, not that such a corporation must hold FCC licenses directly.

Rev. Rul. 66-33 also contravenes the IRS's traditional policy of allowing a tax certificate holder greater flexibility in selecting reinvestment options than taxpayers under Section 1033 generally. The IRS typically allows the tax certificate holder to reinvest in different types of electronic media of mass communication, and the reinvestment may be in the form of assets or stock. 26 U.S.C. § 1033(b)(1990). By contrast, in applying Section 1033 outside the tax certificate context, the IRS has sought to prevent the taxpayer from reinvesting in property of a different nature or function. See, e.g., Filippini v. United States, 318 F.2d 841, 845 (9th Cir.), cert. denied, 375 U.S. 922 (1963). The more flexible approach to Section 1071 transactions advances the remedial intent of the provision more efficiently than does the highly restrictive holding of Rev. Rul. 66-33.[31/]

The adverse effects of Rev. Rul. 66-33 are not academic. By precluding reinvestment in the stock of publicly-traded broadcast stock, Rev. Rul. 66-33 greatly impedes the value of tax certificates for taxpayers who did not realize a sizeable gain on a transaction, and, consequently, do not have sufficiently large proceeds from the sale to reinvest in substantial assets (i.e., another broadcast property). This works a particular

31/ For example, under Section 1071, a taxpayer may reinvest the proceeds from the sale of the assets of a television station in radio station assets, or the proceeds from the sale of stock of the licensee of a radio or television company in the assets of a cable television system.

hardship on taxpayers holding tax certificates as a result of a small investment in a minority-controlled company or former AM licensees who surrendered their licenses in exchange for modest consideration. In these circumstances, publicly-traded stock is often the only feasible reinvestment option. The IRS should revisit and rescind Rev. Rul. 66-33.[32/]

B. Prohibition on Reinvestment in Partnerships

A 1957 Revenue Ruling holds that reinvestment of the proceeds of an asset sale in a partnership would not qualify as replacement property under Section 1033. Rev. Rul. 57-154, 1957-1 C.B. 262. Although Rev. Rul. 57-154 does not involve a Section 1071 transaction,[33/] the IRS has yet to rule that reinvestment in a partnership will qualify in a Section 1071 transaction. An IRS ruling restricting reinvestment of the proceeds of a Section 1071 transaction in a partnership would be unduly restrictive.

The FCC and the IRS should not work at cross purposes in their administration of the tax certificate policy. In 1982, the Commission expanded the minority tax certificate policy to permit a limited partnership with a minority general partner to

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32/ A variant of this proposal was advanced by the National Association of Broadcasters ("NAB") in its petition requesting the Commission to suspend temporarily the processing of applications for new commercial FM stations and for new commercial FM allotments. NAB directed its proposal to the FCC, however, which does not have jurisdiction to rule Rev. Rul. 66-33. See National Association of Broadcasters Request for Temporary Suspension of New Commercial FM Station Allotment and Application Processing, filed Feb. 10, 1992, at 22-24.

33/ In Rev. Rul. 57-154, the IRS held that a taxpayer could not convert condemnation proceeds from the ownership of real property into an interest in a partnership owning similar real property.

qualify as a "minority-controlled" enterprise for purposes of the tax certificate policy.[34/] The Commission did so based on the recommendation of its Advisory Committee that expanding the availability of tax certificates to limited partnerships would increase opportunities for minority entrepreneurs to attract financing.[35/] Without an evident policy justification, application of Rev. Rul. 57-154 under Section 1071 would preclude reinvestment in a significant number of broadcast and cable television transactions, simply because they are partnerships.

Broadening the reinvestment option to include publicly-held corporations operating through subsidiaries and partnerships would do much to enhance the tax certificate. These and other modest adjustments to the tax certificate policy should be further examined in the context of a joint FCC-IRS working group.[36/]

34/ 1982 Policy Statement, 92 F.C.C.2d at 855-59, 52 Rad. Reg. 2d (P & F) at 1305-07. To qualify under the policy, the minority general partner must control the partnership and own at least 20% of its equity. Id.

35/ See Strategies for Advancing Minority Ownership Opportunities in Telecommunications, Final Report of the Advisory Committee on Alternative Financing for Minority Opportunities in Telecommunications to the Federal Communications Commission (May 27, 1982) at 4-6.

36/ The two agencies should enter into a memorandum of understanding setting forth the goals of the joint working group. There is ample precedent for such interagency working arrangements. See, e.g., Memorandum of Understanding Between the Federal Communications Commission and Minority and Small Business Development Agency of the United States Department of Commerce (1982); Memorandum of Understanding Between the Federal Communications Commission and the Equal Employment Opportunity Commission (released August 21, 1978); Interagency Agreement among the Federal Communications Commission, the National Telecommunications and Information Administration and the Minority Business Development Agency (1991) (unpublished).

IV. THE FCC SHOULD REFINE AND EXPAND ITS TAX CERTIFICATE POLICIES

The Commission has become increasingly concerned that the current scarcity of capital available to the broadcast industry will adversely affect broadcast service to the public. As a result, the Commission has recently taken steps to reduce regulatory constraints on investment in the broadcast industry.[37] The tax certificate is a proven, effective regulatory incentive for investment in the broadcast industry.[38] Therefore, improvements to the tax certificate will advance the Commission's efforts to help broadcasters attract capital to the broadcast industry, a particularly difficult obstacle facing minority and small business broadcast owners.[39] Indeed, the Commission has detailed the obstacles facing minority- and women-owned businesses who seek to become PCS and IVDS owners and operators.[40]

37/ See Notice of Proposed Rule Making and Notice of Inquiry in MM Docket No. 92-51, supra note 4; Report and Order in MM Docket No. 91-140, FCC 92-7, supra note 4.

38/ The prices of broadcast stations are typically determined based on multiples of station cash flow. Depending on a seller's basis in a station for tax purposes, a tax certificate enables the seller to reduce the price of the station relative to station cash flow. Because the buyer's lender and investors typically advance funds based on multiples of cash flow, the tax certificate increases the likelihood that the buyer will be able to attract capital to the transaction.

39/ The Department of Commerce reported that from 1990 to 1991, the percentage of minority-owned commercial broadcast stations declined from 2.9% to 2.7%. See "Comparative Statistical Analysis of Minority-Owned Commercial Broadcast Stations," Minority Telecommunications Development Program of the National Telecommunications and Information Administration (October, 1991).

40/ PCS and IVDS Orders, supra note 9.

The following proposals by the Coalition call for modest refinements to the tax certificate policy to bring the policy in line with the economic realities of the broadcast and cable television industries and to make the tax certificate a more meaningful tool to attract capital to both mass media and non-mass media technologies. These refinements are wholly consistent with the intent of the policy and, like prior modifications to the tax certificate policy by the Commission, may be accomplished expeditiously through the issuance of a Policy Statement.

A. **Expansion of the Tax Certificate to Promote Investment By Joint Ventures and Specialized Minority Venture Capital Funds in Common Carrier and Other Non-Mass Media Technologies**

Lack of access to capital is frequently cited as the greatest obstacle to increasing minority entrepreneurship in communications.[41/] As the broadcasting and cable industries mature relative to new, principally common carrier technologies, the Commission must adopt incentives to promote minority entrepreneurship in these emerging areas of telecommunications.

The Commission should capitalize on the proven success of the tax certificate to bring this about. The Coalition proposes that the Commission allow the use of tax certificates by venture capital funds which invest in minority businesses engaged in both mass media and non-mass media technologies. Investors in such a fund would be entitled to a tax certificate upon the sale of their investment in the fund, provided that

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41/ See, e.g., Notice of Proposed Rule Making and Notice of Inquiry in MM Docket No. 92-51, supra note 4, ¶¶ 1, 7, 11; Strategies for Advancing Minority Ownership Opportunities in Telecommunications, supra note 32, at 25; Commission Policy Regarding the Advancement of Minority Ownership in Broadcasting, 99 F.C.C. 2d 1249, 1254, 57 Rad. Reg. 2d (P & F) 855, 859 (1985); PCS and IVDS Orders, supra note 9.

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(i) the fund invests only in minority-controlled businesses and (ii) at least 50% of the aggregate revenues generated by the fund are derived from mass media and wireless technologies (i.e., broadcasting, cable television, MMDS, PCS, IVDS). The fund would be required to certify to the Commission compliance with these conditions at the time that its investors request the tax certificate.[42]

Venture capital funds have been an important source of financing for small and minority businesses. Typically, these funds provide subordinated debt and equity financing. Because they are willing to accept a higher degree of risk than banks and other institutional lenders, venture capital funds are an important source of mezzanine financing for minorities and small businesses. In a recent report on minority ownership in telecommunications, the Commission discussed the importance of venture capital funding to small and minority businesses:

> Examples of such companies are UNC Ventures Inc., Broadcast Capital Fund, Inc. (BROADCAP), and Syndicated Communications (SYNCOM). Since 1977, SYNCOM, a minority owned venture capital firm, has financed over 60 minority ventures in communications. Some of its recent projects have been Emerge Magazine, South Chicago Cable TV, and District Cablevision, Inc., Washington, D.C. BROADCAP, formed in 1979, has helped finance the acquisition of approximately 40 broadcast stations for minority investors. UNC Ventures Inc., a private venture capital company formed over 20 years ago, also has helped finance the acquisition of several

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42/ Assume, for example, that an investor invests $50,000 in the fund in 1992. In 1997, the investor seeks to sell its interest in the fund for $70,000 and receive a tax certificate. The Commission would issue the tax certificate upon receiving a certificate from the fund managers that from 1992 to 1997, more than 50% of the fund's assets were continuously invested in minority-owned or controlled media companies. This would enable the investor to defer capital gains tax on the $20,000 gain. The proposed policy would be sufficiently flexible to permit joint ventures among minority-controlled companies so they can more meaningfully benefit from the tax certificate policy.

significant television and radio properties. These funds continue to provide a vital link to the industry for minority and female investors."[43]

The portfolios of many existing venture capital funds which specialize in funding minority enterprises are heavily concentrated in broadcast and cable companies. These funds helped fuel the expansion of minority ownership of broadcast stations and cable television systems in the 1980s.

As the broadcasting and cable industries have matured relative to other FCC-regulated industries, opportunities for entry level and growth potential have diminished.[44] Thus, it is imperative that the Commission adopt incentives to promote minority ownership in other technology areas. The Coalition's proposal would promote investment in minority ventures which invest in non-mass media technologies, without undermining the constitutional requirement that minority tax certificates promote programming diversity.[45] The proposed expansion of the tax certificate policy would enable venture capital firms that derive a majority of their portfolio revenue from

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43/ Communications and Minority Enterprise in the 1990s, Report of Conference Sponsored by the Federal Communications Commission, the National Telecommunications and Information Administration and Howard University Small Business Development Center (hereinafter "Conference Report"), at 20-21 (March 12, 1992).

44/ The Conference Report noted reports that entrepreneurial opportunities available in radio and television have become increasingly uncertain and involve higher entry costs and somewhat higher market risk relative to other technologies. Conference Report at 51-52.

45/ See Metro Broadcasting, Inc. v. Fed. Communications Comm'n, 110 U.S. 2997, 110 S. Ct. 2997, 111 L.Ed.2d 445 (1990).

investments in minority broadcast and cable transactions to diversify into non-mass media, telecommunications technologies with the benefit of the tax certificate.[46]

For example, an existing or newly created venture capital fund would be able to offer its investors tax certificate benefits for investing in the fund, provided that at least 50% of the fund's assets are invested in minority-owned or controlled broadcasting and cable companies. Such a venture capital fund could diversify its portfolio into, for example, cellular telephone, PCS, electronic publishing, or television production, provided that at least 50% of the fund's assets remain invested in mass media companies.

This proposal would require only minor modification to the tax certificate policy. The Commission's tax certificate policy currently permits issuance of a tax certificate to an investor in a minority-owned or controlled partnership or corporation which, in turn, owns and operates a broadcast station or cable television system. The Coalition's proposal would extend this concept to its logical next step, by permitting the issuance of a tax certificate to the investor in a venture capital fund with a portfolio consisting primarily of minority-owned mass media companies. The fund would have the flexibility to fund non-mass media ventures, provided that at least 50% of its assets remain invested in mass media companies.[47] This proposal would recognize the valuable

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46/ The National Telecommunications and Information Administration of the U.S. Department of Commerce ("NTIA") is currently seeking ways to advance minority ownership in telecommunications. Through its Minority Telecommunications Development Program ("MTDP"), NTIA has proposed the creation of TELECAP, a program to develop new financing strategies to foster minority investment in telecommunications.

47/ The Coalition's proposal is also consistent with the IRS policy of permitting reinvestment in the stock of a diversified corporation with broadcast operations,
(continued...)

contribution of venture capital funds, such as SYNCOM, BROADCAP and UNC Ventures, which pioneered venture capital investment in minority-owned companies. The Coalition's proposal would create incentives for these and similar funds to pioneer minority investment in non-mass media technologies.

B. Elimination of the Requirement that Investors in a Minority Company Must Invest Within the First Year of Operation to Receive a Tax Certificate

Since 1982, the Commission has granted tax certificates to equity investors who provide capital to a minority company during the first year of its operation.[48] The FCC should extend the availability of such a tax certificate to investors who provide funding beyond the first year of operation.[49] The Commission designed this aspect of the minority tax certificate policy to promote investment in new minority companies. The policy has worked well; it is an important means by which minority entrepreneurs attract equity capital.

The Commission adopted the policy in 1982 on the recommendation of its Advisory Committee.[50] But in limiting the availability of the tax certificate to investors

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47/(...continued)
provided that more than 50% of the corporation's gross income is derived from its broadcast activities. See LTR 8421003 (Jan. 13, 1984).

48/ See 1982 Policy Statement, 92 F.C.C. 2d at 855-58; 52 Rad. Reg. 2d (P & F) at 1307-09.

49/ As noted previously, this recommendation applies to investment in PCS and IVDS licensees as well.

50/ Id.; see also Strategies for Advancing Minority Ownership Opportunities in Telecommunications, supra note 32, at 7-10.

who provide financing during the first year of operation, the Commission departed from the Advisory Committee's recommendations:

> [O]ur expansion of the tax policy differs in some respects from that contemplated by the Committee. . . . . [T]ax certificates will only be available to initial investors who provide "start-up" financing, which allows for the acquisition of the property, and those investors who purchase shares within the first year after license issuance, which allows for the stabilization of the entity's capital base. (The Committee's recommendations did not include any time limitation.) We believe that to extend the availability of tax certificates beyond those shareholders would invite abuse and overprotect minority entrepreneurs against the realities of the marketplace which all licensees must face.[51/]

In today's marketplace environment, senior lenders are often unwilling to extend additional funds to established broadcast and cable television businesses to help them to meet working capital or expansion requirements. Often, the only means of meeting these capital needs is through additional equity. This equity is frequently just as difficult to raise as the equity for a start-up business. But at this stage, the stakes are higher; the survival of many minority broadcasters and cable television operators depends on their ability to raise equity to fund ongoing operations -- whether from original or new investors. In this regard, the Commission's one-year limitation on the investor tax certificate unduly restricts access to this important minority ownership incentive and should be eliminated. The Commission should allow investors a tax certificate for an equity investment in a minority-controlled company, even if it occurs after the first year of the company's operations.

51/ 1982 Policy Statement, 92 F.C.C. 2d at 857-859, 52 Rad. Reg. 2d (P&F) at 1306-08.